

MERISTEM EQUITY RESEARCH REPORT



REPORT DATE: APRIL 20, 2007

BUY

12-Month Target Price =N4.71

EXECUTIVE SUMMARY AND INVESTMENT RATIONALE

- Cornerstone Insurance Plc was incorporated on April 26, 1991 and was listed on the Nigerian Exchange on August 13, 1997. The company successfully met the new capital base requirement (N5 billion) before the NAICOM deadline of February 28, 2007 and is registered to conduct Life and non Life (General) insurance business as well as Deposit Insurance and Investment management services..
- It has 3 subsidiaries namely Cornerstone Leasing and Investment Limited (asset leasing, acquisition and other financial solutions), Cornerstone Trustees Limited (providing trusteeship and financial advisory services) and Oak Pensions Limited (pension fund administration in partnership with Express Discount House). Cornerstone also has reinsurance contracts with Swiss Reinsurance Corporation, Africa Reinsurance Corporation, Continental Reinsurance Company Ltd, Universe Reinsurance Company Ltd and Globe Reinsurance Company Ltd.
- Cornerstone is the only insurance company in Nigeria to be rated “AIO Adequate” by the African Insurance Organization in conjunction with Standard and Poor’s London. The rating noted that the company had strong solvency, earnings and underwriting indices. In 1997 it was awarded The Nigerian Insurers Association’s Distinguished Insurer Award and the National Insurance Commission’s Award for Development of New Products in 1999. It also won in 2002 The Nigerian Stock Exchange President’s Merit Award in the Insurance sector for best presentation, quality and depth of its annual report and accounts for the year 2001.

- Capital Alliance Private Equity II Investment Limited (CAPE II) a subsidiary of Capital Alliance Limited (CAL) has injected N3.4billion into the company to become its core investor. It has links with the African Capital Alliance and is partly owned by the International Finance Corporation (IFC). This is seen by analysts as good for the company as CAL has a reputation of using their expertise to add value to their holding companies as well as drive them to amass returns for investors.
- The diversification of Cornerstone's product portfolio, the extra liquidity gained due to the consolidation exercise and the local content policy of the Federal Government in Oil and Gas Industry have availed the company of many profitable opportunities which hitherto were not available.
- The consolidation has put the company in a healthier financial position and has given it the prospect of providing insurance services and underwriting in extremely capital intensive industries such as Oil and Gas, Telecoms and Aviation
- The company is an innovative process driven company with a good brand name and strong presence in the insurance sector. The value of the stock rose from N1.00 to N3.41 (241% share price appreciation) in the past six months and it is expected to rise further as the stock has good fundamentals and prospects for sustained growth and profitability.
- Government reforms in the sector which have made Life Assurance mandatory in some sectors coupled with the growth of the economy and increased awareness of the public of the viabilities of insurance schemes are expected to grow the company's profits.
- We thereby make a **Buy** recommendation on CORNERSTONE given the anticipated synergistic growth in Net Premium and Net Income post-consolidation.

The Global Insurance Industry

Heavyweights such as Allianz AG, AXA, AIG, ING Groep and Nippon Life Insurance dominate the global insurance market. It should therefore come as no surprise that an estimated 90% of global insurance value added is derived in the western hemisphere whereas the emerging markets (though growing) only account for 10%. Globally, the international

sector is recovering from a decade long slump which has seen pressure on the industry coming from the 9/11 attacks as well as natural disasters such as earthquakes and hurricanes.

The recession in the industry has also come on the back of reduced gains from volatile international stock markets, increased competition and the internet serving to disable middlemen. Companies have faced declining margins and return on investments as well as a lack of re insurance cover. They have responded with improved underwriting practices, cost cutting measures and better risk management which have reduced their exposure to claims.

Resurgence has already been witnessed as market confidence has grown and the number of strategic alliances between international insurance firms and brokers has risen. However, the global market will be progressing with caution as regulation will play a dominant role in defining the future of the market e.g. German Pension Fund reform, Nigerian Consolidation exercise etc.

The present and immediate future of the sector will be predicated on the customer. More than ever before insurers are making their products more customer friendly in order to increase profits. This is premised on the assumption that improved knowledge of the customer will enable insurers to better meet their needs. Insurers will thus be able to better align their pricing and business strategies within the needs of their niche clientele and reap the rewards.

The Nigerian Insurance Industry

The insurance sector has generally been sub standard and fragile over the past few years due to low penetration, lack of knowledge about the benefits of insurance on the part of consumers and inadequate capital adequacy. This has led to a thinning of margins and reduction in profitability of insurance companies. This served as the catalyst for the Federal Government mandated consolidation of the sector in which Life insurance firms had to capitalize to the tune of N2billion and General insurance firms were to raise N3billion while firms wishing to have both licenses had to have N5 billion.

The consolidation has come and gone with 71 out of 168 insurance firms surviving it. The exercise has brought about renewed belief in the sector with both local and offshore investment flowing into the industry and strategic alliances being established, one could thus be forgiven for being optimistic that the insurance terrain will change for the better. All

things being equal, consolidation will create a stronger industry with greater profits and underwriting capabilities. The strategic alliances are expected to improve corporate governance and transparency as well as partner the insurance firms as they evolve from risk management and underwriting firms to full fledged financial services firms.

The public perception of the industry has changed as it is now believed that the industry is a viable investment option. Banks have also invested heavily in Insurance as they search for means to increase their returns on equity and assets. However, it has not all been rosy for the sector as it is plagued by competition which has led to sharp practices such as price/rate cutting and non settlement of claims. The sector still suffers from inadequate belief on the part of the public as premiums are not paid on time. The increased inflow of funds has also created a problem of ensuring increased returns to investors. With margins dwindling due to increased competition, insurance firms will have to venture into new areas of business to create the returns necessary to make investors happy. It is anticipated the industry may witness another phase of industry induced Capitalisation just as it is happening in the banking sector.

Risk Profile

The company is faced with increased competition in , an industry where undercutting is rife and has reduced margins in the sector. The company is very innovative and has entrenched itself in the market in a way that enables it take advantage of new opportunities and is well positioned to grow its earnings by capitalizing on its increased capital outlay. A currency risk exists for Cornerstone but this is mitigated by an effective internal risk management strategy that limits Losses on foreign exchange transactions. Regulatory risks exist as the Federal Government has put forward 5 different form of legislations affecting the insurance sector in the last 15 years. Cornerstone's consistent pursuit of increased profitability, sustained growth and increased shareholder value serve as evidence that it can and will weather any storm.

Future Outlook

The prospects for Cornerstone Insurance Plc are very good. The constant growth of the Nigerian economy as well as increased awareness on the part of the public as to the benefits of insurance services all augur well for the company. Favourable Government policies such

as the new pension reform and local content policy for the oil and gas sector will impact positively on the company's balance sheet. The inflow of investment and strategic alliances are set to improve corporate governance and will also help the company find viable sources of investments so as to improve profitability and increase returns to shareholders. Nigeria remains one of the least penetrated markets in terms of insurance coverage in the world. The sheer size of the nation makes it a potential prospect.

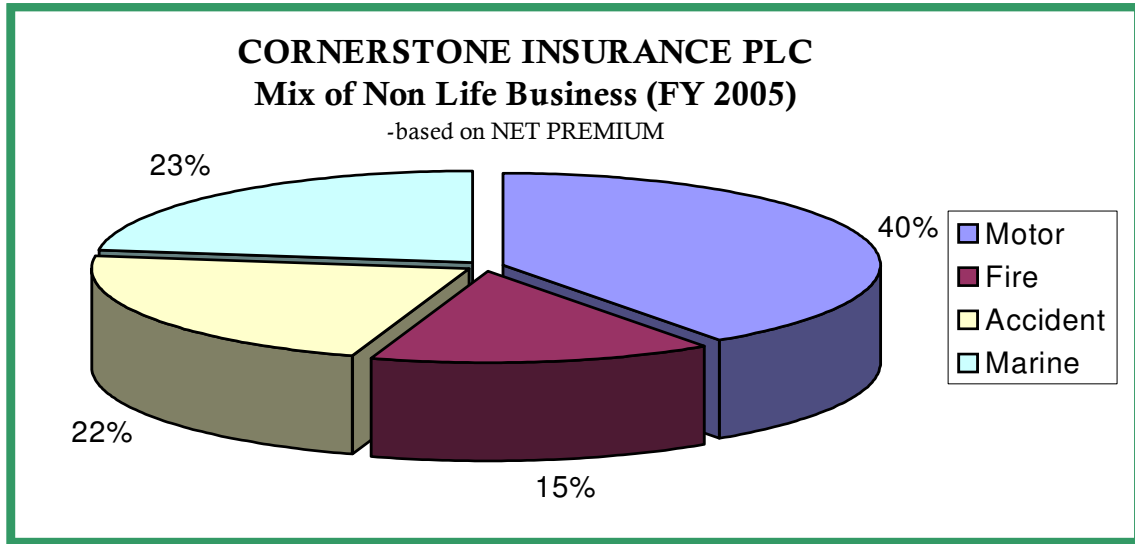
ANALYSIS OF FINANCIALS:

BUSINESS MIX:

Cornerstone Insurance Plc as a General Insurance Company generates its incomes from both Life and Non Life businesses. However, the bulk of its income is derived from non-life businesses, which include Motor, Fire, Accident and Marine insurance.

A review of the company's latest financials for the year ended December 2005 revealed that 95.8% of its net premium was accounted for by its Non-life businesses and these businesses cornered a significant proportion (91%) of the company's total underwriting profit.

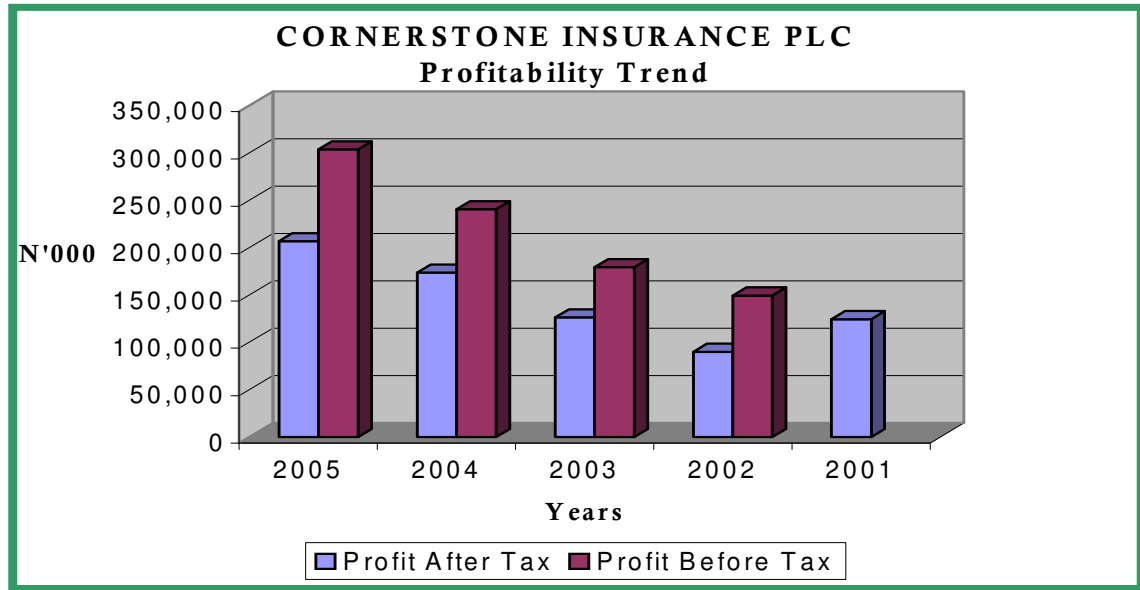
Similarly, in Cornerstone's Non-life businesses; **Motor Insurance** is the company's cash cow, generating 40.3% of its Net Premium while Fire Insurance; Accident and Marine Insurance contributed 14.6%, 22.4% and 22.7% of the Net Premium respectively. The Motor Insurance business is the most profitable service unit with a profit margin of 34.4% while Fire and Accident Insurance recorded 29% and 20% respectively. On the other hand, the company's Marine Insurance could be christened as its "dog" business unit accounting for a loss of 4.8% during the same year, thereby shrinking the company's underwriting profit to N253.5m.



PROFITABILITY:

Cornerstone increased its after tax profit by an average annual rate (**Compounded Annual Growth Rate-CAGR**) of 13.5% while Profit After Tax (PAT) soared from N124.6 m in 2001, (though with a drop of 28% in 2002) to N206.7m in 2005. This can be attributed to growing awareness and increased patronage of the insurance business in the country as the company grew its net premium by a 3-year average annual rate of 46.9%. This is comparable to most of its peers' performance with similar growth in net premium per annum over the corresponding periods.

The company recorded a Return on Total Assets (ROTA) of 9.4% and a Return on Equity (ROE) of 13.3% in the 2005 financial year. These are slight improvement over 8.9% and 13.1% recorded in the preceding financial year respectively. As seen above, a trend analysis of the growth in the company's ROTA & ROE did not match that of PAT. Put differently, the company is not making an optimum use of its assets as reflected by the ratios. This may be a key area that the management needs to look at.



EFFICIENCY:

Cornerstone's efficient performance cannot be divorced from its improved cost ratios. The company's Policy Claim Ratio (Non-life) which expresses the Net Claims from policy holders as a proportion of the Net Premium earned from all policy holders declined from 35.9% in 2003 to 22.5% in 2005 while the Policy Claim ratio (Life) followed a similar pattern, nose-diving sharply from 108.2% to 22.8% over same period. This can be linked to marked improvement in the system of appraising risks to be assumed by the company.

Another important cost ratio; Expenses Ratio revealed an efficient cost management strategy, dropping from 95.2% in 2003 to 62.7% in 2005 for Non- life businesses, with the same ratio for Life business declining from 158.2% in 2002 to 81% in 2005.

The Expense Ratio examines the extent of an insurance company's underwriting expenses and net claims paid in relation to the size of the net premium earned. Therefore, a declining index indicates increasing efficiency in risk management as well as cost management and control and vice-versa.

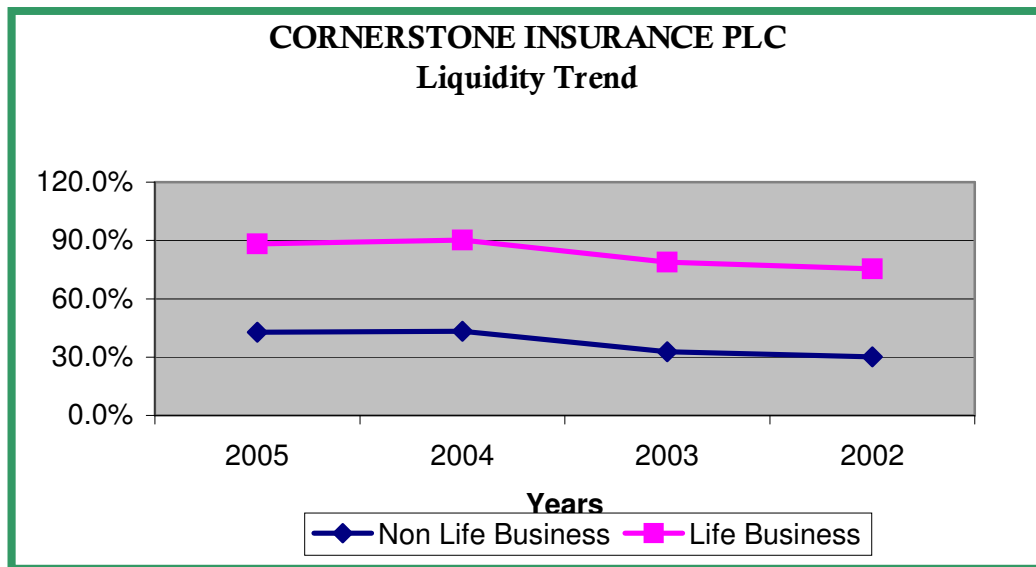
LIQUIDITY & SOLVENCY:

The ease with which an insurance company can meet up with payment of claims is a critical success factor for all players in the industry, especially in a typical African country like Nigeria where trust in the business of insurance is almost lost until recently.

Cornerstone Insurance recorded impressive performance on all liquidity indices for the period under review.

The company grew its liquid assets (cash and short-term investments) at an average annual rate of 36.6% higher than 31.4% at which it grew its total assets thereby ensuring sufficient liquidity even in the face of its growing businesses.

The growth in liquid resources relative to total assets is accountable for the increasing ratio of liquid assets (cash and short term investments)/total assets which witnessed a leap from 75.4% to 88.2% from 2002 to 2005 for Life business and an increase from 36.7% in 2001 to 42.9% in 2005 for Non Life Insurance business.



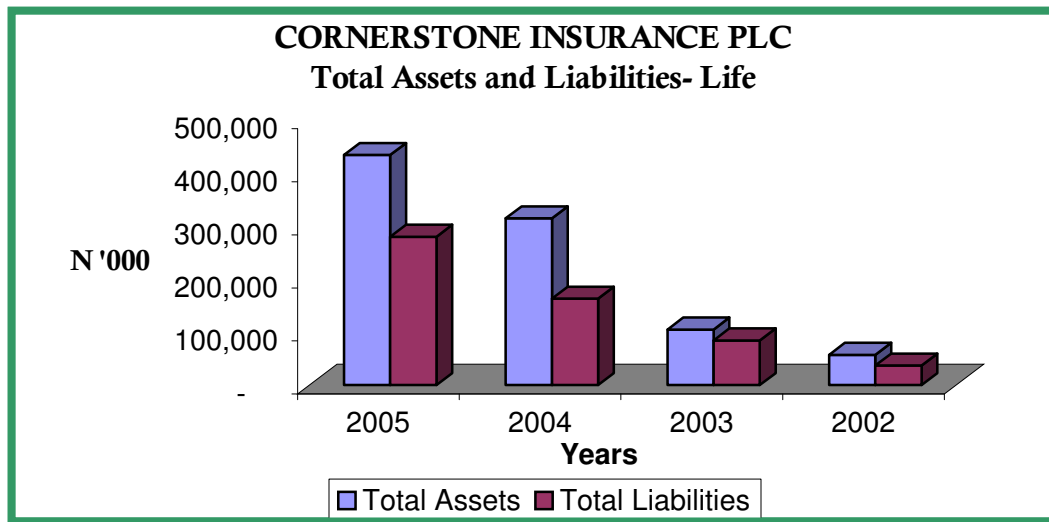
Also, the company's permanent assets over the review period, has constituted a diminishing portion of the total assets of the company as the ratio of Permanent Assets to Total Assets fell from 10.7% in 2002 to 2.9% in 2005 for Life business and moving from 24.3% in 2001 to 13.7% in 2005. This could be a pointer to improving liquidity position supporting the company's quick ratio which averaged 1.32 for Life business and 0.74 for Non- Life business.

In other words, this implies that Cornerstone has sufficient liquid assets to cover all liabilities arising under its Life Assurance business 1.316 times and will not cover only 25.6% of its total liabilities from its cash and short term investment for the Non Life business.

Furthermore, the company recorded sound solvency indicators both for its Life and Non-Life businesses its assets provide adequate cover for its liabilities. Over the 5 years reviewed, the average Debt Ratio (Total Liabilities to Total Assets) was 65.3% and 50% for the Non Life and Life businesses respectively.

CAPITAL ADEQUACY:

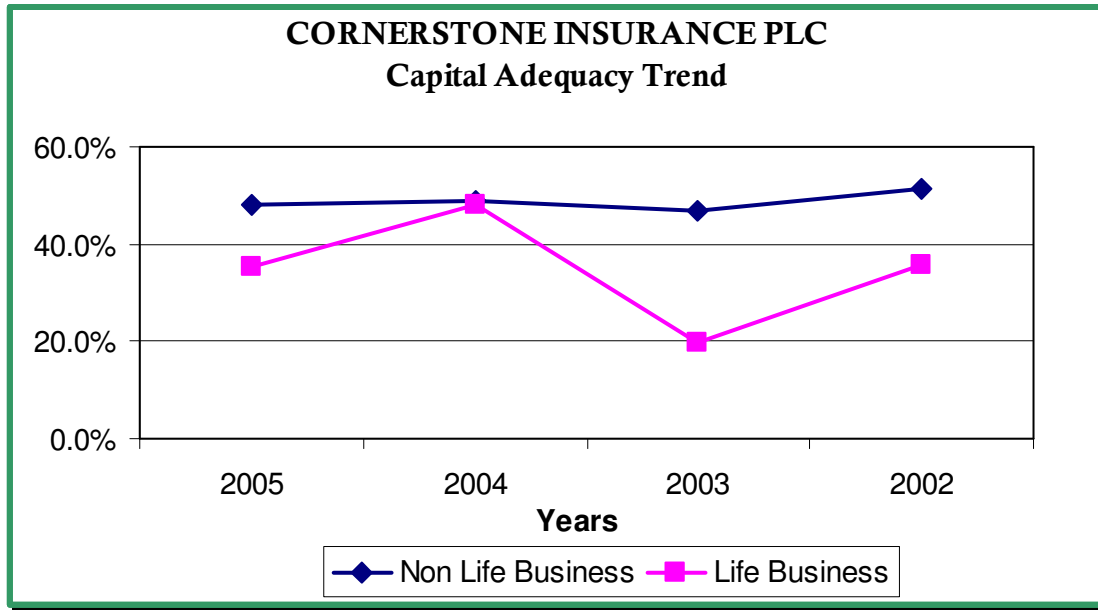
The shareholders fund of the company hit N1.55 bn in 2005 as against N600m recorded in 2001. This translates to an increase by 58.65%, most of which can be attributed to the injection of fresh funds through its Rights Issue in 2004. For the Life business, the extent by which Total Assets is financed by equity measured by Equity to Total Asset fell from 35.7% in 2002 to 19.6% in 2003. The ratio improved in 2004 with a quantum leap to 48.2% in 2004 but later decline by 26.3% to 35.5% in 2005. Similar trend was exhibited by another metric- the proportion of Permanent Asset financed by Equity (Equity to Permanent Assets).



However, the company’s owner net worth (Equity) was more than sufficient to finance its permanent assets. For the Non-life business, Equity to Total Assets declined from 55.4% (2001) to 46.8% (2003) before it got a boost by the virtue of the Rights Issue which increased it to 49%. In 2005, however, there was a slight decline. Likewise for the Life business, the Equity to Permanent assets showed a healthy capital status of the Company.

By and large, it is believed that the recently concluded recapitalisation exercise in the Insurance Industry will go a long way in improving the capital position of the company as

well as that of other players in the industry.



DIVIDEND & BONUS HISTORY:

Cornerstone Plc has consistently paid dividend annually for the past 5 years. Though it has a fluctuating pay-out ratio, it paid out more than 70% of its earnings in 2004 and 2003, but less than 50% in 2005, 2002 and 2001. The company has maintained an average annual payout of 60.1%; meaning that over the past 5 years, it has continually retained about 40% of its profit, paying the rest to its shareholders as cash dividend.

Meanwhile, in terms of earnings and dividend yields, Cornerstone Insurance performance review revealed a not-too-impressive trend. There has been a consistent decline in earnings yield from 26.8% in 2001 to 10.3% in 2005. In the same vein, the dividend yield followed a similar pattern, nose-diving from 12.8% in 2001 to 8.6% in 2005.

However, the company has a rich bonus payment history, declaring bonus in financial years 2002, 2003 and in 2005.

VALUATION:

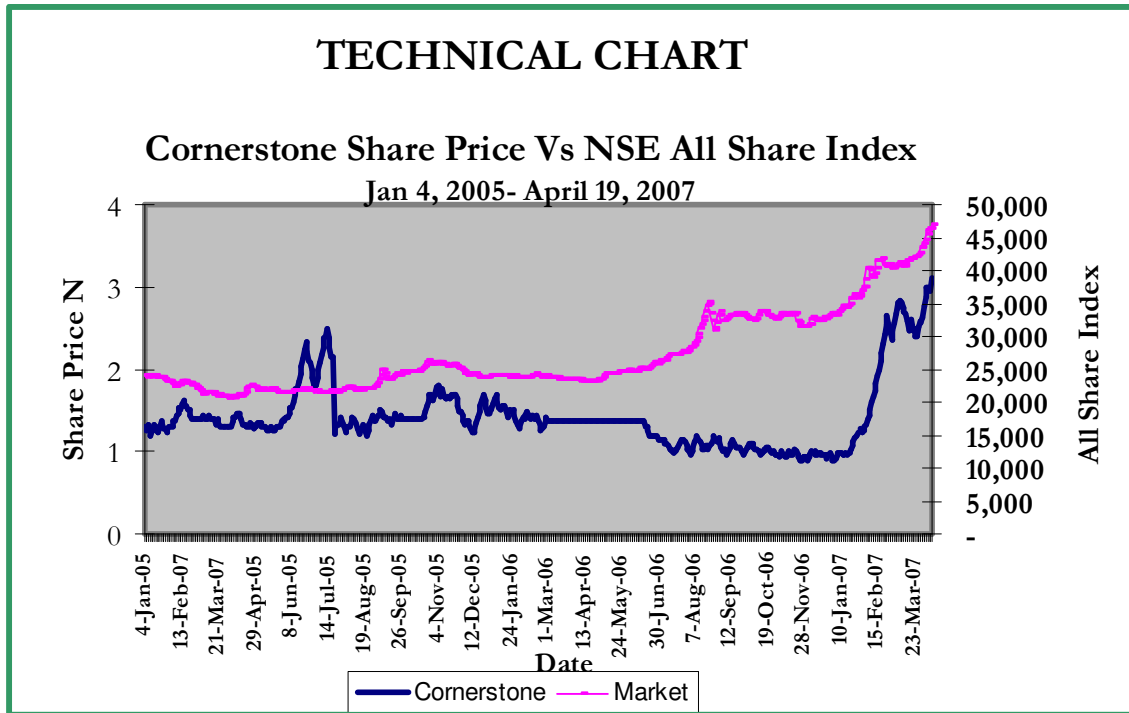
We have estimated the worth of Cornerstone Insurance Plc employing the Embedded Value Approach used by insurers and investors internationally, and a couple of Relative Valuation Metrics such as the Price to Book Value (P/BV) and Price to Earnings (P/E) metrics. In arriving at a fair value for the stock, we attached weights to each of the metrics in order of their appropriateness in insurance businesses. We are more overweight in the Embedded Value method and P/BV given the peculiarity of the industry. In our final analysis, we arrived at an intrinsic value of N4.71. Put differently, the stock is currently trading at a discount of 28% to its current market price of N3.41k as at Thursday April 19, 2007.

INSURANCE INDUSTRY PEER REVIEW

COMPANY	Industry	Cornerstone	Crusader	Lasaco	Nigerins	Prestige	Royalex	StdAllian	Unic
Price(Ngn)-April17, 2007.	-	3.10	6.36	2.39	5.59	5.75	5.4	3.43	4.85
S/Outstanding (bn)	-	4.37	1.96	1.18	1.50	1.01	1.60	3.47	7.95
Mkt Cap Nbn	103.70	13.56	12.49	2.81	8.39	5.82	8.65	11.90	3.86
EPS(Ngn)	1.41	0.04	0.50	0.10	0.24	0.23	0.08	0.07	0.15
P/E	39.82	81.18	12.36	19.21	18.48	19.26	58.49	40.55	31.67
Earnings Yield	3.5%	1.3%	7.9%	4.2%	4.3%	4.0%	1.5%	2.0%	3.1%
Book Value Nbn	1.646	1.551	1.858	1.340	2.089	1.421	1.954	1.670	1.285
BVPS	1.07	0.35	0.95	1.14	1.39	1.40	1.22	0.48	1.62
Volatility (β)	0.14	0.09	0.12	0.09	0.30	0.07	0.33	0.07	0.01

CORNERSTONE PLC: KEY STATISTICS

Market Capitalisation (Nbn)	<i>13.547</i>
Shares Outstanding - Units bn	<i>4.37</i>
P/E	<i>16.32</i>
P/BV	<i>8.74</i>
Trailing BV/Share (N)	<i>0.35</i>
EPS (N)	<i>0.19</i>
Earnings Yield (%)	<i>11.7</i>
Payout Ratio	<i>47.6</i>
DPS (N)	<i>0.05</i>
Dividend Yield (%)	<i>5.6</i>
Current Share Price (N)-April 17, 2007.	<i>3.10</i>
Year High (N)	<i>3.10</i>
Year Low (N)	<i>0.90</i>
Average Volume Traded (YTD)- Units	<i>27,204,503</i>
Average Volume Traded (5-day) - Units	<i>50,268,139</i>
Security Beta (β)	<i>0.10</i>



TECHNICAL ANALYSIS:

The performance of Cornerstone Insurance like most of other Insurance companies has been below that of the Market as indicated in the Technical Chart above. This observation is supported by both the Industry Beta (0.14) and the Security Beta of Cornerstone Insurance (~ 0.1).

In other words, a 1% swing in the market performance will translate to a 0.14% price fluctuation in the average insurance stock performance vis-à-vis a 0.1% price change in Cornerstone.

A look at the historical price movement for Cornerstone shows that the price oscillates between the support level (Low) of N1.20 and the resistance level (High) of N1.63 from January 4, 2005 to June 9, 2005. The old resistance level was first broken in 2006 when the stock recorded a new all-time high of N2.49. The stock opened at N1.58 in 2006, recorded a Low of N0.89 and closed the year at near Low of N0.90.

Similarly, in 2007 following the successful completion of the recapitalisation exercise in the industry and the subsequent increased interest of investors coupled with influx

of foreign equity participation in the industry due to the anticipated prospects, the stock has consistently maintained an upward trend since the beginning of the year 2007. Cornerstone closed at N3.41 on Thursday April 19, 2007 to record a new all-time high price.

An extrapolation of the recent trend in the market price movement of industry players in the sector suggests that Insurance Industry will begin to perform at least at par with the market in months and perhaps years ahead.

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